

Final Statement of Reasons
Department of Water Resources Revenue Requirement and Just and
Reasonable Determination Regulations

Update on Initial Statement of Reasons

On May 9, 2003, the California Water Commission held a meeting and approved DWR's proposed regulations pursuant to Water Code section. Consistent with Government Code section 11347.3 the Department has made a copy of its file of rulemaking in this matter available for public inspection.

Material Relied Upon

In proposing these regulations, DWR has relied upon the Rate Agreement between the DWR and the CPUC as approved pursuant to Decision 02-02-051. This information was disclosed in the Department's Initial Statement of Reasons. A copy of the Rate Agreement can be found at the Department's website at www.water.ca.gov.

Evaluation of Alternatives

The Department has determined that the alternatives discussed below would be more effective in carrying out the purpose for the regulations.¹ DWR considered the use of ad hoc procedures for the determination of each revenue requirement and for each just and reasonable determination, but decided that the establishment of procedures of general application would improve the opportunity for meaningful public participation in such determinations. DWR also considered not adopting a regulation to implement, interpret, or make specific the "just and reasonable" standard of Public Utilities Code section 451 as applied in the context of Division 27 of the Water Code, but decided that the public would be better served by adopting such a regulation. Finally, consistent with PG&E's recommendation DWR considered applying the requirements of the APA for the promulgation of regulations to a determination of revenue requirements. The Department has not adopted this recommendation for among other reasons the fact that a determination of revenue requirements is a regulations. A determination of revenue requirements is essentially a calculation with a specific application. Moreover, the APA provides no guidance on how to determine whether a revenue requirement is just and reasonable within the meaning of AB 1X. The Department has determined that no alternative by the agency would be more effective in carrying out the purpose for which the regulation is proposed or would be effective and less burdensome to affected private persons than the adopted regulation.

¹ As explained herein, these regulations do not have an adverse economic impact on small businesses. Accordingly, none of the alternatives considered would lessen such an impact on small businesses. See, Govt. Code section 11346.9(a)(5).

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Mandate on Local Agencies or School Districts

These regulations do not impose a mandate on local agencies or school districts because they do not require local agencies or school districts to do anything or to abstain from doing anything. Rather, the regulations merely establish a procedure that may be used by local agencies or school districts to provide input on the determination of revenue requirements and on just and reasonable determinations. The regulations may benefit local agencies or school districts that are purchasers of power under DWR's Power Purchase Program by providing an opportunity for increased participation in a determination as to whether charges paid by the retail end use customers are just and reasonable.

Local Mandate Determination

The Department has determined the regulations do not have a fiscal impact on any local entity or program. Any Department of Water Resources costs from conducting the just and reasonable determination pursuant to Water Code section 80110 are attributable directly to the statute. All of these costs are apart of the revenue requirement the Department must recover pursuant to Water Code section 80134.

Response to Comments on Proposed Regulations

I. Introduction

On April 18, 2003, the Department received written comments from Pacific Gas and Electric Company ("PG&E") in response to the Notice of Proposed Rulemaking Action ("Notice") which appeared in the March 7, 2003 California Regulatory Notice Register published by the Office of Administrative Law ("OAL"). In the Notice, the Department proposes adopting permanent regulations that establish procedures for public participation in the determination of a revenue requirement under Division 27 of the Water Code and standards for whether the Department's revenue requirement is just and reasonable ("Rulemaking Action"). The last date for submission of comments in the Rulemaking Action was April 21, 2003. No other comments were received by the Department.²

In its comments, PG&E requests that the Department withdraw the proposed regulations from consideration in this Rulemaking Action.³ The Department does not agree with PG&E's recommendation. PG&E assumes that

² Southern California Edison (SCE) did not submit any written comments, however it did inquire into whether DWR's emergency regulations were extended beyond the 180-day limitation set forth in Government Code section 80014. DWR responded affirmatively and provided SCE with documentation that verified OAL's renewal of DWR's emergency regulations.

³ Comments of PG&E at p. 1.

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the procedures set forth in the California Administrative Procedure Act (“APA”) apply to the Department’s determination of a revenue requirement. The Department disagrees. Consistent with the requirements of Government Code (“Govt Code”) § 11346.9(a)(3), the Department provides the following response to PG&E’s comments.

II. DWR’s proposed regulations are not unlawful because the process for public participation in the determination of a revenue requirement is different than the procedures for promulgating regulations under the APA.

PG&E first argues that the proposed regulations are unlawful because they provide for different procedures than those set forth in the APA for the promulgation of a regulation. Specifically, PG&E complains that the proposed regulations (a) provide less than a forty-five (45) day notice period prior to the issuance of a just and reasonable determination, (b) establish a different form of notice than the notice contemplated by Govt Code § 11346.5; (c) fail to include the requirement that DWR consider alternatives to a revenue requirement determination or potential adverse economic impacts; (d) allow DWR to exclude information from the public record; and (e) fail to require DWR to submit a determination of revenue requirements to the Office of Administrative Law.

In this Rulemaking Action, the Department is considering the adoption of a hearing procedure and standards for a determination of revenue requirements under Assembly Bill 1 of the First Extraordinary Session of 2001 (“AB 1X”)⁴ PG&E has conflated the applicability of the APA to the promulgation of the Department’s proposed regulations under AB 1X with the Department’s determination of revenue requirements (which itself is not a regulation). Under PG&E’s approach each and every revenue requirement determination would be considered a regulation subject to the processes and requirements set forth in the APA.

PG&E seeks to extend the requirements of the APA beyond promulgation of the proposed regulations in this Rulemaking Action. PG&E provides no legal support for its position. Moreover, PG&E’s interpretation and application of the APA is not sustainable for at least two reasons.

The revenue requirement is not a “regulation”, as that term is defined in the APA. A regulation subject to the APA has two principal identifying characteristics: (1) the agency must intend its rule to apply generally, rather than in a specific case;⁵ and (2) the rule must “implement, interpret, or make

⁴ California Water Code at § 80000 et seq.

⁵ Govt Code § 11342.600 provides that a regulation “means every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law

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specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure.”⁶

A revenue requirement determination made by the Department pursuant to the proposed regulations will not establish a rule of general application, nor does the Department intend for any particular determination of revenue requirements to apply generally. To the contrary, for each revenue requirement determination, the Department will consider specific facts for a specific period of time. Successive determinations will be made for specified time periods, on an annual or more frequent basis. The Department intends to make revenue requirement determinations in accordance with the statutory requirements of Assembly Bill 1 of the First Extraordinary Session of 2001 (“AB 1X”), on a case by case basis, separately for each year. Thus, each periodic establishment of a revenue requirement is a one-time activity which does not meet the statutory definition of a “regulation.”

Second, a determination of revenue requirements in and of itself does not implement AB 1X. The determination merely establishes the Department’s costs associated with its power supply program. To accomplish this, the Department identifies all the costs and projected costs attributable to the program for a particular period and aggregates such costs to derive the Department’s revenue requirement. Hence, the revenue requirement determination is not a rule that will implement, interpret, or make specific a law that will be enforced or administered by the Department. The revenue requirement is essentially a calculation of costs associated with the Department’s power purchase program.

PG&E also argues that DWR’s Rulemaking Action and proposed regulations are not consistent with the June 7, 2002 Judgment Granting Writ of Mandate, Sacramento Superior Court Case No. 01CS01200. PG&E’s reliance on the Court’s Writ of Mandate is misplaced. In that case, PG&E sought a writ of mandate to require DWR to comply with the APA in reaching a just and reasonable determination pursuant to AB 1X. The Court determined that Water Code § 80110 triggered the protections of the APA and ordered DWR to follow procedures mandated by the APA before making any determination of whether its revenue requirements are just and reasonable.

The Department has complied with the Court’s order by promulgating emergency regulations under the APA as authorized by AB 1X. The emergency

enforced or administered by it, or to govern its procedure.” *Id.* See also, *Sherwin Williams Company v. South Coast Air Quality Management District* (2001) 86 Cal. App. 4th 1258, 1283 (*cert. denied* 2001 Cal. LEXIS 3317); *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal. 4th 557, 571-572.

⁶ Govt Code § 11342.600. An agency’s action is a regulation only if it is intended as a rule of general application.

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regulations established a hearing procedure and set standards by which the Department would make a just and reasonable determination. Through this Rulemaking Action and pursuant to the procedures set forth in the APA, the Department is promulgating permanent regulations. PG&E's contention that the Department has not complied with the Court Order is wrong. The Court did not order the Department to promulgate each revenue requirement determination as a regulation. PG&E's argument fails to distinguish between the Department promulgating rules as provided in this Rulemaking Action and the Department making determinations pursuant to such rules.

PG&E's approach would also require the Department to submit its revenue requirement determination to OAL. It is unclear why PG&E seeks this relief, or what, if anything, OAL would do with the Department's revenue requirement determinations. OAL has no authority to allocate the Department's revenue requirement among retail customers of energy delivered by DWR. Under Division 27 of the Water Code and the provisions of the Rate Agreement between the Department and the CPUC, the Department must submit its determination of revenue requirements to the CPUC for purposes of allocation among retail customers.⁷ As such, it is apparent that PG&E has misinterpreted the Court Order because implementing PG&E's suggestion would not serve any valid purpose nor would it make any logical sense.

III. The Notice of Proposed Rulemaking Action is legally sufficient.

PG&E devotes a substantial portion of its comments to critiquing the Notice and arguing that the Notice contains incomplete and inaccurate statements. PG&E's allegations are not well-founded. For example, PG&E complains that the Notice fails to disclose that emergency regulations adopted by DWR on June 7, 2003 were automatically repealed after 180 days. PG&E also contends that the Notice fails to disclose that the Department improperly attempted to re-issue its emergency regulations.⁸ Contrary to PG&E's claim, the Department renewed its emergency regulations with the approval of the Office of Administrative Law. This approval was provided on December 5, 2002. PG&E's argument on this point is without merit.

PG&E also complains that the Notice does not reference litigation commenced by PG&E in Sacramento Superior Court regarding, among other things, the applicability of the APA to the Department's determination of revenue requirements under AB 1X.⁹ Govt Code § 11346.5 governs the contents of a Notice of Proposed Rulemaking Action and requires that a Notice of Proposed Rulemaking Action contain in relevant part:

⁷ Water Code §§ 80110 and 80134; Rate Agreement adopted by CPUC Decision 02-02-051 at §4.1(b).

⁸ Comments of PG&E at pp. 4-5.

⁹ Id. pp. 5-6.

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Reference to the authority under which the regulation is proposed and a reference to the particular code sections or other provisions of law that are being implemented, interpreted or made specific.¹⁰

An informative digest containing a concise and clear summary of existing laws and regulations, if any, related directly to the proposed action and the effect of the proposed action.¹¹

The Notice contains a detailed reference to the provisions of AB 1X, which the proposed regulations would implement as well as an informative digest that provides a concise description of relevant Water Code sections directly related to the proposed regulations. PG&E provides no authority for its assertion that the Notice is deficient. In fact, there is no legal requirement that DWR provide a detailed and exhaustive description of all matters related to the proposed action. Such a narrative would undermine the requirement that an informative digest be a concise and clear summary. Nevertheless, in response to PG&E's comments, the Department will include a concise description of the Sacramento Superior Court's Writ of Mandate in the Department's Final Statement of Reasons submitted to OAL.

PG&E further asserts that the Department's Initial Statement of Reasons provided to OAL contains an inaccurate statement that the proposed regulations are exempt from the APA under a ratemaking exemption.¹² As PG&E's comments concede, the Department and PG&E are currently litigating the issue of whether revenue requirement and just and reasonable determinations are essential steps in a ratemaking proceeding. In short, the Department's position is that without the Department's determination of revenue requirements there could be no proceeding at the Commission by which the revenue requirement is allocated in rates among customers situated in the service territories of the investor owned utilities. This issue is currently subject to an appeal before the California Court of Appeal for the Third District. PG&E's comments do not demonstrate that the Department's Initial Statement of Reasons is inconsistent with the requirements of Government Code § 11346.2(b)(2), which requires that the Department provide a specific purpose for the adoption of regulations. The Initial Statement of Reasons correctly reflects the Department's position that these regulations are not subject to the APA under the APA's ratemaking exemption.¹³ The Department clearly indicates that the purpose for the adopting

¹⁰ Govt Code § 11346.5(a)(2).

¹¹ *Id.* at § 11346.5(a)(3)

¹² Comments of PG&E at pp. 6-7. See, Govt Code § 11340.9(g).

¹³ PG&E asserts the Department's position contradicts its own statements because the Department references AB 1X which provides that the Department may promulgate regulations

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these regulations is to formalize the procedures for public participation in the Department's revenue requirement and just and reasonable determinations. Consistent with Government Code § 11346.2(b)(2), the Initial Statement of Reasons also describes the specific purpose of each and every proposed regulation the Department is considering adopting.

IV. The Notice of Rulemaking Action provides sufficient information to support an initial determination that the proposed regulations will not have a significant adverse economic impact on business.

In its comments, PG&E asserts that the Department's Initial Statement of Reasons provided to OAL does not contain sufficient information regarding the impact of the proposed regulations on businesses in California.¹⁴ PG&E argues that the Department's Initial Statement of Reasons provides only conclusory statements. The Department disagrees with PG&E's assessment. Government Code § 11346.2(b)(4) states that an Initial Statement of Reasons shall include:

Facts, evidence, documents, testimony, or other evidence on which the agency relies to support an initial determination that the action will not have a significant economic impact on business.

The Initial Statement of Reasons does include an initial finding the proposed regulations do not have an adverse impact on business. This initial finding is supported by the fact that the proposed regulations are merely procedural. The proposed regulations establish procedures for public participation in the determination of a revenue requirement and standards to determine whether the revenue requirement is just and reasonable. This fact supports the Department's initial finding that the proposed regulations will have no financial impact on business and is sufficient for purposes of the Department's Initial Statement of Reasons.¹⁵ PG&E's comments ignore this straightforward analysis to argue that costs incurred by the Department may have a great impact on businesses that must pay for those costs in electricity rates. PG&E then argues that the proposed regulations could lead to high retail electricity costs for businesses.¹⁶ PG&E also asserts that applying the procedures set forth in the

under the APA. PG&E's assertion, however, fails to recognize that even though regulations may be promulgated under the APA, those regulations may be subject to the APA's ratemaking exemption.

¹⁴ Comments of PG&E at pp. 7-8.

¹⁵ *Pulaski v. California Occupational Safety and Health Standards Board* (1999) 75 Cal. App. 4th 1315, 1328-1331, interpreting California Government Code 11346.2 to mean that an agency's Initial Statement of Reasons need not cite any studies, reports or documents to assess the economic impact of proposed regulations except those studies, reports or documents on which the agency relied.

¹⁶ PG&E contends that DWR has reduced its revenue requirements each time scrutiny of the Department's revenue requirements has increased. The Department disputes this contention.

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APA will lead to lower retail electricity costs for businesses. PG&E's provides no legal or factual support for this argument. The Department does not believe PG&E's arguments demonstrate that the Initial Statement of Reasons is legally deficient.

Consistent with Government Code § 11346.3, the Department has assessed that the proposed regulation will not have an adverse effect on business or individual, including the elimination of business or jobs within California. However, consistent with Government Code § 11346.3(2), the Department shall consider the information provided by PG&E in its Final Statement of Reasons submitted to OAL.

V. The Notice of Proposed Rulemaking Action appropriately solicits alternatives to the adoption of the proposed regulations.

Finally, PG&E argues that the Department's Initial Statement of Reasons fails to include a sufficient alternatives analysis to support the adoption of the proposed regulations.¹⁷ Government Code §§ 11346.2(b)(3)(A) and (B) require an Initial Statement of Reasons to include (1) a "description of reasonable alternatives to the regulation and the agency's reasons for rejecting those alternatives" as well as (2) a "description of reasonable alternatives to the regulation that would lessen any adverse impact on small business and the agency's reasons for rejecting those alternatives."

In its Initial Statement of Reasons, the Department identifies the alternatives it has considered, including ad hoc procedures for the adoption of revenue requirement determinations, as well as not adopting a regulation to implement the "just and reasonable" standard of Public Utilities Code § 451 as applied in the context of Division 27 of the Water Code. However, in an effort to increase public participation in the Department's revenue requirement and just and reasonable determinations, the Department rejected these alternatives in favor of the proposed regulations. In addition, the Department has initially determined that the proposed regulation does not have an adverse impact on small business. As a result, there is no requirement to provide a description of reasonable alternatives to the proposed regulations that would lessen any adverse impact on small business and the Department's reasons for rejecting those alternatives.¹⁸ The Department's Initial Statement of Reasons complies with Government Code §§ 11346.2(b)(3)(A) and (B).

The Department's power purchase program is a cost-based program. There is no incentive for the Department to determine a revenue requirement at a level higher than is necessary.

¹⁷ Comments of PG&E at p. 9.

¹⁸ In this instance, the failure to include an alternatives analysis that specifically mentions small business constitutes at most technical noncompliance given that the Department initially determined that the proposed regulations will have no adverse impact on small businesses. Technical noncompliance does not render the Initial Statement of Reasons or any regulations

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PG&E's comments criticize DWR for not considering the alternative of simply applying the procedures set forth in the APA to each and every determination of revenue requirements. As discussed above, the Department has considered PG&E's proposal to treat each and every revenue requirements determination as a regulation subject to the procedures of the APA. However, the Department's determination of revenue requirements cannot be adopted as a regulation because it does not meet the definition of a regulation. For the reasons set forth herein, the Department does not believe PG&E's approach is a reasonable alternative to the adoption of the proposed regulations.

VI. Conclusion

For the reasons set forth above as well as the reasons sets forth in the Department's Initial and Final Statements of Reasons submitted to OAL, the Department denies PG&E's request that the Department withdraw the proposed regulations from consideration in this Rulemaking Action.

Adverse Impact on Small Businesses

These regulations do not have an adverse impact on small business because they do not require business to do anything or to abstain from doing anything. Rather, the regulations merely establish a procedure that may be used by businesses to provide input on the determination of revenue requirements and on just and reasonable determinations. The regulations may benefit small businesses that are purchasers of power under DWR's Power Purchase Program by providing an opportunity for increased participation in a determination as to whether charges paid by the retail end use customers are just and reasonable. PG&E asserts that the history of the California energy crisis requires a rigorous just and reasonable review and that an adequate review should involve public participation. The regulations provide for increased public participation in revenue requirement and just and reasonable determinations. PG&E also asserts that in light of the California energy crisis, the regulations could lead to higher retail electricity costs. There is no evidence in the file of rulemaking that would support such a speculative assertion.

Regulations Mandated by Federal Law or Regulations

These regulations do not adopt or amend a regulation that is mandated by federal law or regulations.

adopted as a result thereof invalid. *Pulaski*, 75 Cal. App. 4th 1315, 1328: "where there is compliance as to all matters of substance technical deviations are not to be given the stature of noncompliance. Substance prevails over form."